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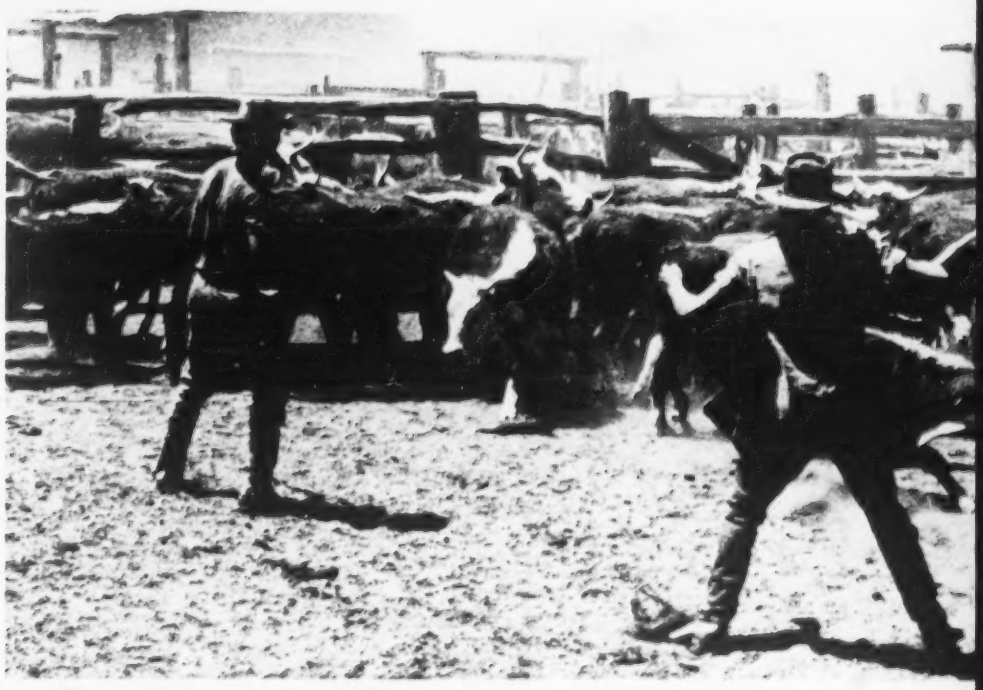
Economic Times



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Serving Business and Society Since 1916

Editor's Note

Many interesting items this time, ranging from the Industry Outlook Report (center section) to auto insurance fraud to a national service corps to advice from the most famous spymaster about how to deal with the Russians. We also provide, as always, our "Stat File" and "Crystal Ball," the former including a one-page chart story on mutual fund flows.

The cover photo comes to us courtesy of The Broken Hill Proprietary Company Limited of Australia. We trust all our readers have had or will shortly have a refreshing vacation.

Ed Fiedler

Maxim of the Month:

The optimist thinks that this is the best of all possible worlds, and the pessimist knows it.

J. Robert Oppenheimer

Rethinking a National Service Corps

by Bruce K. MacLaury

This nation is quite appropriately engaged in some deep soul-searching in the aftermath of the Rodney King case and the ensuing riots. While the acquittal of the Los Angeles policemen reemphasizes the immense importance of justice in a democratic society, the riots reemphasize the importance of law and order. Both kindle inflammatory questions about the role of race.

Rodney King's poignant question, "Can't we all just somehow get along?" demands a response not just in a renewed search for common values, but in reality of new opportunities. Where can we start? An idea that has received too little attention is an expanded national service corps to provide an alternative for unemployed teenagers faced with little more than street gangs and drug dealing. It is ironic that with the end of the Cold War, we are downsizing the armed forces, the very institutions that have the best record in our society of offering employment and training to disadvantaged youth. But what better time to devise a new civilian mission for the armed forces, to take advantage of the training skills of officers and non-coms, many of them minorities, as well as some of the training facilities that will otherwise have to be abandoned?

A national service corps could not only provide a structural learning environment for otherwise unemployed young people—offering them an opportunity to broaden horizons, learn valuable skills, and build values of discipline and responsibility—but also help protect the environment and rebuild the infrastructure. Combine such service with education credits for subsequent use to continue or seek advanced training, and one is really talking opportunity.

Moreover, like the armed forces, a national service corps can help bridge the gap between rich and poor and people of all colors. And with the provision of real opportunity, society need not feel concern or guilt for strict law enforcement directed against those who choose crime rather than opportunity.

Like most proposals offering this kind of opportunity, a national service corps would require tax funding. There is no free lunch. But it is hard to think of programs that promise so much in the way of payoffs as one that creates job opportunities and training for unemployed youth, a new mission for an underemployed army, a ticket to further education, an escape from crime-ridden city streets and housing projects, an environmental dividend, and experience in a cross-culture common cause that could help break down the barriers that separate us.

Excerpted from "Rediscovering the Common Good" in *The Brookings Review*, Summer 1992. Bruce K. MacLaury is president of the Brookings Institution.

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Colloquium: On Industrial Policy

Background:

The performance of the economy and the election campaign have renewed the controversy over the idea known as "industrial policy" or "national economic planning" or "technology policy."

Question:

Is this something the United States government should pursue? Which aspects of the idea should be emphasized? Which should be avoided?

Murray Weidenbaum
Center for the Study of American Business

INDUSTRIAL POLICY—UGH! Proposals for industrial policy demonstrate the advantages of recycling. Proponents only have to repackage and relabel the standard proposal for a more activist federal role in the economy. In turn, critics merely have to cite the long and sad litany of past efforts (ranging from the RFC scandals of the 1950s to the synfuel boondoggle of the 1970s). Why object to the ritual? It helps to create employment for economists at the profession's time of need.

Andrew F. Brimmer
Brimmer & Company, Inc.

The U.S. should *not* adopt an "industrial policy." The latter would require government officials to choose which products, processes, and production techniques would receive financial assistance. Because such officials are far removed from planning offices, research laboratories, and factories in the private sector, they lack the knowledge to make such choices. However the government should expand tax incentives for private R&D efforts by firms—which would continue to decide what, how, and for whom products and services are to be produced.

Don Conlan
The Capital Group, Inc.

If individual companies—with everything to lose—can't see the future, who thinks the government can? The government can, however, set fair limits on workmen's compensation litigation, find ways to constrain health care costs, stop trying to artificially support the U.S. dollar, forbid structural increases in the Federal budget deficit (to reduce long-term interest rates) and then stand aside and be surprised by the resourcefulness of American business.

John T. Dunlop
Harvard University

Wisdom is in the details, not in the sound-bites and cliches of winners and losers. Basic research, matched support for applied, non-military research and development, physical infrastructure and transport, energy policy, and skilled work force development—these are areas of industrial policy the government has long been in. The task for the future is a greater collaboration of the private and public sectors in focusing priorities and providing effective execution and applications.

Members:

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The Car Insurance Lottery

by J. David Cummins & Sharon Tennyson

The legal environment plays a critical role in driving up auto insurance costs. It is simply too easy and too profitable to file bodily injury liability claims on auto insurance. In most states—those with tort and low-threshold, no-fault systems—motorists experiencing minor accidents effectively receive a lottery ticket. The ticket gives them a high probability of winning some amount of money (like $5,000) and a low probability of no gain. The lottery winnings are the motorist's share of a "pain and suffering" award. The price of the ticket is small.

Here's how it works: Driver A is involved in a minor accident where he sustains no injury but it is reasonably clear that the other driver is at fault. Driver A enters the lottery by visiting a lawyer who sends him to a cooperating physician, who conducts some tests and administers some treatment. The lawyer then files a claim against the driver who hit driver A. The cost of the lottery ticket to driver A is the physician's fee plus the time required to visit the lawyer and the doctor. The lawyer charges no fee up front but is entitled to a share of the lottery winnings (perhaps a contingency fee of 33 percent).

The insurer of the other driver now faces a dilemma. It suspects that driver A was not injured, but has received detailed documentation including a diagnosis and statement of treatment by a licensed physician. Furthermore, the claim is relatively small. The insurer calculates the expected costs of defending against the suit and finds that the costs exceed the expected gain (the amount of the suit times the probability of a successful defense). It settles out of court, and driver A has won the lottery.

Several elements must be present to operate a successful personal injury lottery. First, the game must be played frequently to permit the lawyer to take advantage of the law of large numbers, because not all suits are successful. Second, there must be many physicians to choose from because of the low proportion of physicians willing to provide treatment for non-existent injuries. Third, driver A must be aware of the lottery and have easy access to a lottery attorney. Fourth, driver A must be able to play for a relatively low cost, which implies that the cost of the driver's time and the physician's up-front fee must be low. Fifth, the utility value to driver A of winning a few thousand dollars must be high. Finally, the court system must be sufficiently sympathetic to bodily injury claims so that the insurer's expected payoff from resisting the claim is lower than the cost of taking the case to court.

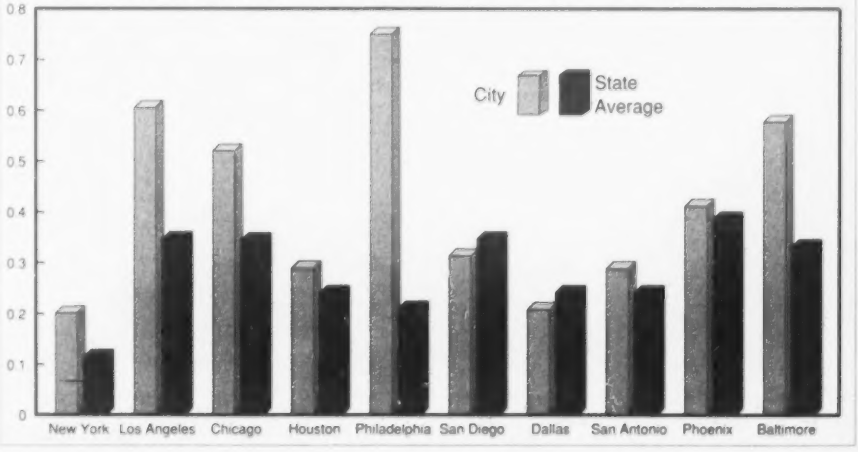
These elements suggest that insurance lotteries are most likely to develop in areas where accident frequency is high, physicians and lawyers are easily accessible, information about playing the lottery can be widely disseminated, the utility value of winnings is high, and the cost of drivers' time is low. In short, insurance lotteries are most likely to develop in densely populated areas with economic problems and court systems that favor the plaintiff.

Statistical evidence consistent with the insurance lottery hypothesis is provided by calculating the likelihood of filing a bodily injury claim in relation to the number of accidents. The frequency of property damage liability (PDL) claims is the best available estimate of the relative number of accidents in different geographic areas. While not every accident leads to a PDL claim, one would not expect the rate of PDL claims per accident to vary significantly by location. PDL claims are much less susceptible to fraud because it is relatively easy to determine whether a vehicle has been damaged and effective mechanisms such as arbitration are in place to assign negligence without the necessity for a lawsuit.

The accompanying chart shows the ratio of bodily injury liability (BIL) to property damage liability claims for the nation's 10 largest cities and, for com-

Car Insurance Lotteries?

Ratio of Bodily Injury Liability Claims to Property Damage Liability Claims, 10 Large Cities, 1985-87



parison, the average ratio for the entire state. In nearly every instance, the BIL/PDL claim ratio is higher in the large city than in the state as a whole. This evidence strongly suggests that car insurance lotteries are in operation in many urban areas. This evidence is particularly convincing in view of the fact that accidents occurring in urban areas typically are less severe than those in less densely populated areas because they occur at lower speeds.

A second source of evidence on the insurance lottery is provided by a detailed closed-claim study conducted by the Automobile Insurers Rating Bureau of Massachusetts. The Bureau investigated 597 bodily injury claims and estimated that over 30 percent of the claims involved explicit fraud or apparent overstatement of damages. The most successful insurance lottery was in Lawrence, a city long beset by high unemployment and crime rates. A high proportion of the claims involved the same doctors and lawyers. Both sets of evidence persuasively indicate that fraud is widespread in auto insurance settlements.

What to Do.

Besides more vigorous enforcement, probably the best way to stop insurance lotteries is to adopt no-fault insurance with tort claims limited by a verbal definition (as in Michigan, for example, where "pain and suffering" suits are permitted only in cases of death, serious impairment of bodily function, or permanent serious disfigurement) or with tort claims subject to an economically meaningful dollar threshold. This type of no-fault regime eliminates the right to sue for relatively minor injuries, thus removing from the system the smaller claims, for which insurer resistance is not cost-effective. Insurers have a stronger economic incentive to resist larger claims, so a smaller proportion of questionable claims is likely to receive compensation under no-fault.

In no-fault states that discourage pain-and-suffering suits, the number of bodily injury liability claims per 100 property damage liability claims increased only 3 percentage points from 1980 to 1989. By contrast, over the same span that ratio increased 7 percentage points in tort and add-on states, and 11 percentage points in states with low-dollar tort thresholds. It seems clear, therefore, that a well-designed no-fault car-insurance regime has great potential for curbing inflation in bodily injury liability premiums.

Excerpted from the *Journal of Economic Perspectives*, Spring 1992. J. David Cummins is Professor of Insurance and Sharon Tennyson is Assistant Professor of Insurance, both at the Wharton School, University of Pennsylvania.

Quotable Quote

Murray Weidenbaum on Defense Company Downsizing

Defense companies need to continue the painful downsizing now underway. They must maintain the financial ability to operate in a different market environment—or they will go under.

Most economic conversion proposals are characterized by naivete and wishful thinking. At best they are a diversion. At worst, they will dissipate the remaining assets of defense contractors. The numerous past attempts by defense contractors to use their factories and people to penetrate civilian markets have resulted in few successes. The abandoned projects run the gamut from canoes to coffins. Most of the undertakings have failed, either being closed down or sold at a loss. Defense companies are different from civilian companies. Proctor & Gamble cannot make missiles and General Dynamics cannot produce soap or potato chips (at least not at competitive prices).

Trying to get commercial payoffs from military technology is invariably an enticing concept. But the past sad history of military contractors attempting to enter commercial markets should discourage the government from trying to forcefeed that process.

Individual defense firms need to understand that, like companies in other industries, they have no particular claim to maintaining their present size, or even to their continued existence—nor do their employees possess any special rights to the jobs now generated by defense spending. Most of these firms will find that a more modest scale of operations is also a more efficient scale in the decade ahead. This advice is consistent with the response of the chairman of Martin Marietta when asked by the Russians how to convert a tank plant into a refrigerator factory: Tear down the tank plant and build a new refrigerator factory.

Forcing defense contractors to try to penetrate alien markets is no favor to their employees—who would find themselves abruptly laid off when those ventures failed. Those now out of work are better advised to seek employment elsewhere. It is foolhardy to ignore the evidence. As a study by Battelle Memorial Institute concluded: "Detailed research has not identified even one successful product in our economy today which was developed through a military-to-civilian conversion approach."

Excerpted from *Small Wars, Big Defense*, Oxford University Press, 1992. Murray Weidenbaum is Mallinckrodt Distinguished University Professor and Director of The Center for the Study of American Business at Washington University in Saint Louis.

Le Carre on the Bear

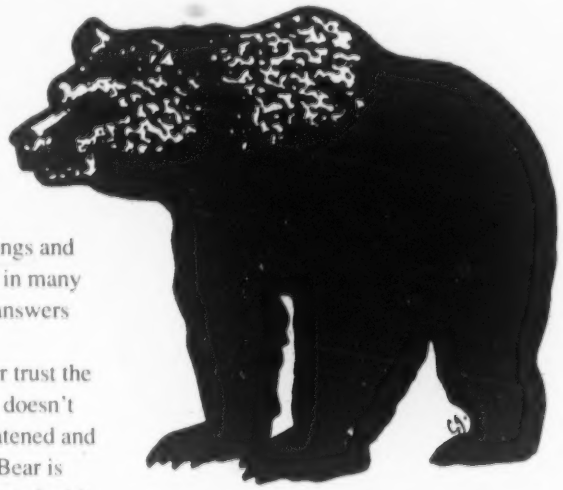
John Le Carre's book,* The Secret Pilgrim, *closes with his famous spy, George Smiley, making the following discourse about the collapse of the Soviet Union to a group of young recruits to the British Intelligence Service.

It was *man* who ended the Cold War in case you didn't notice. It wasn't weaponry, or technology, or armies or campaigns. It was just *man*. Not even Western man either, as it happened, but our sworn enemy in the East, who went into the streets, faced the bullets and the batons and said: we've had enough. It was *their* emperor, not ours, who had the nerve to mount the rostrum and declare he had no clothes. And the ideologies trailed after these impossible events like condemned prisoners, as ideologies do when they've had their day. Because they have no heart of their own. They're the whores and angels of our striving selves.

You asked me how we should think of Russia today. You ask, can we ever trust the Bear? You seem to be amused, yet a bit unseated, by the notion that we can talk to the Russians like human beings and find common cause with them in many fields. I will give you several answers at once.

The first is no, we can never trust the Bear. For one reason, the Bear doesn't trust himself. The Bear is threatened and the Bear is frightened and the Bear is falling apart. The Bear is disgusted with his past, sick of his present and scared stiff of his future. He often was. The Bear is broke, lazy, volatile, incompetent, slippery, dangerously proud, dangerously armed, sometimes brilliant, often ignorant. Without his claws, he'd be just another chaotic member of the Third World. But he isn't without his claws, not by any means. And he can't pull his soldiers back from foreign parts overnight, for the good reason that he can't house them or feed them or employ them, and he doesn't trust them either. And since this Service is the hired keeper of our national mistrust, we'd be neglecting our duty if we relaxed for one second our watch on the Bear, or on any of his unruly cubs. That's the first answer.

The second answer is yes, we can trust the Bear completely. The Bear has never been so trustworthy. The Bear is begging to be part of us, to submerge his problems in us, to have his own bank account with us, to shop in our High Street and be accepted as a dignified member of our forest as well as his—all the more so because his society



and economy are in tatters, his natural resources are pillaged and his managers incompetent beyond belief. The Bear needs us so desperately that we may safely trust him to need us. The Bear longs to wind back his dreadful history and emerge from the dark of the last seventy or seven hundred years. We are his daylight.

The problem is, we Westerners do not find it in us naturally to trust the Bear, whether he's a White Bear or a Red Bear, or both kinds of bear at once, which is what he is at the moment. The Bear may be in perdition without us, but there are lots of us who believe that's exactly where he belongs. Just as there were people in 1945 who argued that a defeated Germany should remain a rubble desert for the rest of human history.

The Bear of the future will be whatever we make of him, and the reasons for making something of him are several. The first is common decency. When you've helped a man to escape from wrongful imprisonment, the least you can do is provide him with a bowl of soup and the means to take his place in a free world. The second is so obvious it makes me a little intemperate to have to mention it at all. Russia—even Russia alone, shorn of all her conquests and possessions— is a vast country with a vast population in a crucial part of the globe. Do we leave the Bear to rot?—encourage him to become resentful, backward, an over-armed nation outside our camp? Or make a partner of him in a world that's changing its shape every day?

It's not only our minds we're going to have to reconstruct, either. It's the over-mighty modern State we've built for ourselves as a bastion against something that isn't there any more. We've given up far too many freedoms in order to be free. Now we've got to take them back.

So while you're out there striving loyally for the State, perhaps you'll do me a small favor and lean on its pillars from time to time. It's got a lot too big for its boots of late. It would be nice if you would cut it down to size.

Excerpted from *The Secret Pilgrim* by John Le Carre. Copyright © 1991 by John Le Carre. Reprinted with permission of Alfred A. Knopf, Inc.

Industry Outlook Report

Overview: Mixed Pattern, Moderately Optimistic

Edgar R. Fiedler
The Conference Board

The industry specialists contributing to this month's Report—in a pattern similar to the contributors of this past January and April—are on balance moderately upbeat about prospects for 1992 and 1993. Specifically, recovery in demand is expected for paper and other wood products, steel, petroleum, packaged foods, telecommunications equipment and services, and in agriculture for grains and oilseeds. Weakness is seen, however, in oil and gas exploration and farm equipment purchases.

The international dimensions of the outlook yield a varied picture with an optimistic tilt. In pulp and paper, world recovery in 1993 is a prime force leading to much higher industry operating rates. Outside the OECD countries, petroleum demand continues to grow. U.S. exports of telecommunications equipment should also rise further. But in steel, weaker exports and slightly higher imports are expected to offset most of the pluses in demand arising from domestic sources.

The outlook for inflation, however, is mixed. There is of course a natural conflict of interest here, because the higher selling prices that boost profits in one industry add to costs in the next industry. Consumers, however, are mainly interested in price stability, and from that point of view there is unhappy news about wood products, petroleum, and packaged foods; in each of those sectors, prices seem more likely to rise than fall from here. But stable prices are expected for steel, and only a 1-2 percent increase is anticipated in 1993 for consumer foods. On balance, the 1993 inflation rate does not seem likely to deviate far from the present 3-4 percent rate.

The most encouraging news on prices is reported from the grass roots of the apparel business, where consumers have adopted a new psychology for the 1990s. Conversations at cocktail parties have shifted 180 degrees away from the old emphasis on expensive designer dresses. The refreshing new focus is pride in the latest bargain find. The apparel industry is, we trust, listening carefully.

Forest Products: Price Hikes Coming

Lynn Michaelis
Weyerhaeuser

The forest products industry has continued to be a good barometer of the general economic situation. Housing and wood products activity soured in the first quarter of 1992. The euphoria over what had appeared to be the first signs of a robust recovery has waned. Home sales have declined. Lumber prices have retreated from the peak levels of March. Export sales, which had been strong in 1992, have slowed dramatically. For instance, exports of linerboard (used in making boxes) are unchanged in 1992, after surging 14 percent in 1991.

Prospects for the industry over the next 12-24 months depend on two very distinct forces. The first will be the recovery in demand. Recent efforts to stimulate the economy through lower interest rates should help revive single family starts. As the recovery proceeds in 1992, consumer confidence should rebound, as will remodeling expenditures. Lumber and panel demand are expected to grow another 8 percent in 1993—or up nearly 20 percent from 1991 levels. Inventories are still very low.

The second force will be the limits on timber supply. There have been no public timber sales in the West Coast region on U.S. Forest Service lands for 18 months. Under recent changes, nearly 90 percent of federal land in Washington will be locked up permanently. Proposed harvest cutbacks will cause West Coast lumber and plywood output to drop another 10-20 percent. When combined with restrictions in other producing regions, wood-product prices are expected to move up sharply in 1993 as demand recovers. In a classic example of how a competitive market works, prices will have to rise high enough to induce enough new supply to offset the shortage created by public policy choices that restrict supply.

Oversupply in the pulp and paper industry is being corrected. Prices have already bottomed for most products. The collapse in investment, combined with a world recovery in 1993, should lead to much higher operating rates by the end of 1993 and improving profits.

	1991	1992e	1993f
Lumber Demand (BBF)	43	46	50
Panels Demand (BSF)	24	26	28
Lumber Price (2x4, Spruce)	187	230	250
Plywood Price (1/2", South)	191	220	240

Petroleum: Price Turn Ahead

Brian O'Connor
Eunec Consultancy
Ltd (U.K.)

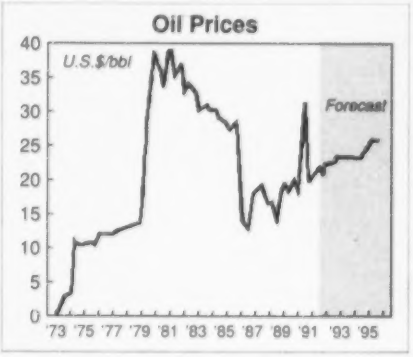
This July the German discount rate was raised to a level not seen since 1931-32. European economic activity will be held back and the ability of the United States to continue to call on international short term capital to finance recovery will be reduced. Meanwhile, in Japan, output continues to fall. World inflation is being reined in, but at a cost in jobs and output.

In this deflationary environment the petroleum industry is suffering with all other energy producers—profits and share prices have fallen by 50 percent or more. In such a climate, what are the omens for the near future?

Petroleum demand outside OECD countries continues to grow, with the largest increment occurring in the Peoples Republic of China. Energy prices in real terms are at their lowest for nearly 25 years and energy demand per unit of GDP has now ceased to fall and may again be rising. Oil and gas will remain the preferred fuels while prices remain low.

In contrast, new supply is being affected. The problems of the former Soviet Union are well known and will not be resolved swiftly. Cutbacks in worldwide exploration programs and in numbers of skilled staff will restrict the rate at which new oil and gas developments will occur. The recent fall in the ratio of oil reserves to production will thus continue. Only the Middle East offers any hope for major additional oil supplies, but, here too, existing capacity is becoming obsolete and in need of enhancement.

Global inventories are adequate for the weak demand now being experienced. Recent price movements are consistent with average global cover for all users staying in the range 85-95 days. The maintenance of current OPEC restraint seems likely to result in trading values oscillating through a range of $18.50 to $25.00 for Brent Blend, with WTI and Dubai crudes approximately $2.00 above and $1.50 below Brent respectively.



Food Industry: Still Growing

Len Teitelbaum
Merrill Lynch

Without exception, participants in the packaged food industry have been hurt by the recession. Normal consumption patterns have been disrupted, private label goods have gained market share and an economically battered consumer has made "low price" the leading brand name. The supermarket, having lost customers to the Club stores, has exerted a "share-the-pain" strategy in trying to protect margins on lower volumes.

Considering the above, the outlook is probably more favorable than one would assume. While it may be too early to predict the end of the recession, statistics on purchase patterns indicate conditions may be stabilizing and in some cases private labels are giving up market share to branded goods. We have also seen evidence of selected price increases lately.

It seems axiomatic to say "no matter what, people have to eat," but profitability on what is sold may be more relevant. For 1993, the key to profits will be marketing expenses and cost containment. Packaged food companies must spend smarter to increase operating margins. Prices can be raised (as the cereal industry did) but "judiciously" is the byword. Food companies admit that 1992 was indeed a "wake-up call" and many are reacting accordingly. We look for slight margin improvement in 1993.

Normally we would project the industry to gain 11-13 percent with one or two companies at 15 percent. In 1992 we will be happy with 10-12 percent and in 1993 hopefully returning to 11-13 percent annual rate as the year unfolds. Europe will still hold fascination for U.S. companies and we expect to see acquisitions by CPC International, Campbell Soup and Hershey; before 1993 ends at least one large merger may be seen. In the meantime marketing alliances or strategic partnerships are forming with increasing regularity. Depending upon the company this could raise the growth rate one-half to one percent in any given year.

Steel: Modest Gains

Elizabeth A. Bossong
Economist

Winning the Cold War has concentrated our focus on the domestic scene. Our problems are magnified under the lens, and encourage the new pessimism. Nevertheless, despite concerns about the productivity trend, deficits, the S&L debacle, and other events, we should see economic growth of about 2 percent this year and more than 3 percent in 1993.

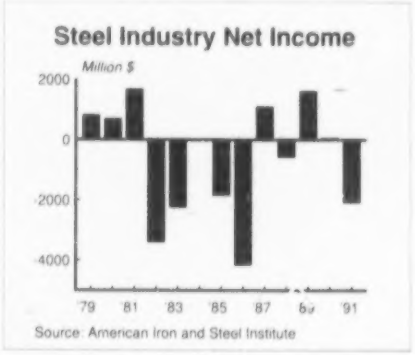
Changes in steel will be modest. In 1991, steel consumption fell by 6.5 million tons, and an inventory swing from accumulation in 1990 to liquidation cut another 3 million tons from demand. However there was a solid improvement of 4 million tons in the steel trade deficit. Shipments, as a result, dropped by only 6 million tons to 70 million.

This year, private nonresidential building activity will continue to weaken, offset by further gains in public construction and housing. Industrial machinery output will be flat for the year. Improving auto and truck sales combined with low inventories are driving automotive production schedules upward, and total 1992 output will increase by more than a million units.

Total steel usage should increase by nearly 1-1/2 million tons. A reversal of last year's inventory run-off will add another 1-1/2 million tons. However, weaker export demand and slightly higher imports will offset most of those pluses. Total industry shipments will be little changed at 79-80 million tons.

Stronger economic growth in 1993 reinforced by the steel-intensive capital goods markets and continuing gains for autos and appliances will permit a healthier 3 million-ton increase in actual steel consumption next year. Industry shipments should reach 82 million tons.

Steel earnings collapsed in 1991, with lower volumes and price cutting driving net income deeply into negative territory. Those losses should narrow this year because of continuing cost reduction. Next year should see a return to modest profitability with improved volume and stable prices.



Source: American Iron and Steel Institute

Apparel: Ever Changing

Ed Johnson
Johnson Redbook Service

The frequent downturns in the apparel industry are well known and can arrive quickly with little forewarning. They are caused by unpredictable cutbacks in consumer spending on apparel, periods of unseasonably warm or cold weather, and excess inventories at retail. Weather plays an increasingly important role as consumers buy closer and closer to needs rather than according to the calendar. Sweaters and other cold weather gear will have a slow start for the fall if warm balmy weather expands past September. Conversely spring and summer apparel won't be bought early in April and May if the weather stays frigid.

We have gone through two of these mini slowdowns in the past nine months. One last fall as general merchandise retail sales slowed to year-to-year increases of 2 to 3 percent when financially strapped consumers turned to the goodies already in their closets as opposed to what is normally an ever present lust to have something new. This craving for newness returned starting on December 22 with retail sales jumping smartly ahead through February. This rebound was aided by spring-like weather in the first two months of 1992. Then apparel sales declined through the end of May, largely due to unseasonably cold weather. However, June sales improved slightly as warm weather arrived and pent-up consumer demand took over.

More important is the recent major change in consumer psychology. In recent years these changes have run in ten-year cycles. The period of the 60's was a dress-up era with a strong emphasis on brand names. This reversed in the 70's with a dress-down era—holey jeans and sloppy shirts were in vogue. There was a strong trend toward buying at thrift shops and little desire for brand names. The 80's emphasized dress up, brand names, high-priced designer labels, and snob appeal. The 90's have ushered in a new era of so-called "reverse snob appeal." The talk at cocktail parties is about the latest bargain purchased rather than the expensive new designer label. This trend is putting downward pressure on apparel company margins as stores look for lower prices. Department stores and high priced specialty stores are suffering. Conversely, discount stores, warehouse clubs, and factory outlets are flourishing.

Telecommunications: Renewed Expansion

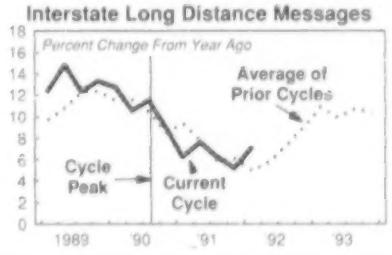
Ken Militzer
AT&T

Spending for telecommunications services increased right through the 1990-91 recession, but the equipment side of the industry was hurt by cutbacks in the local exchange carriers' construction programs. In the long distance market, message growth in the current cycle has been similar to what occurred during previous cycles (see chart). It slowed through late-1991, but is now moving back up along with the recovery in the overall economy. If it continues to follow the pattern of earlier cycles, growth will accelerate further—to the 10-12 percent range by 1993.

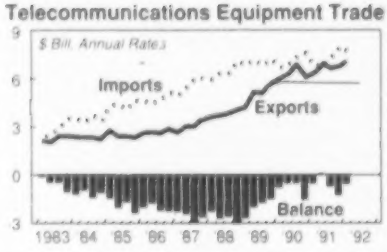
Growth in the number of telephone lines in service—one of the factors affecting the local carriers' revenue growth and their spending for new equipment—is also moving back up after slowing during the recession. The growth in lines is considerably slower than the growth in long distance volumes, but in 1993 it should get back to about the 3 percent rate it had been following before the recession drove it down to 2 percent.

Since the local carriers' spending for new equipment fell during the recession, export sales became an important source of growth for domestic manufacturers. Increasing exports have also been the predominant force behind the improved trade balance in telecommunications equipment over the past three years (see chart). Early in 1992, exports were up 13 percent from their year-ago level, and the trade deficit was running at a $500 million annual rate (down from $560 million last year and from a peak deficit of $2.8 billion in 1988). Exports should continue to increase, contributing to renewed gains for domestic manufacturers, as economic growth abroad picks up later this year and in 1993, and as U.S. access to many foreign markets improves.

Interstate Long Distance Messages



Telecommunications Equipment Trade



Agriculture: Food Prices Not Threatening

John Schnittker
Schnittker Associates

The food sector is increasingly sensitive to recession as more highly processed products dominate supermarket shelf space. Food prices at retail increased only 1 percent in the past 12 months; food at home rose even less. Declining meat prices, with more pork and a perennial increase in poultry meat, also contributed to stability. Increased water supplies in the West aided fruit and vegetable production.

U.S. and world prospects for 1992 grains and oilseeds are clouded by early yield losses in the United States, uncertainties about the former U.S.S.R., and concern about a weak monsoon in Asia. Conditions in late July support harvests equal to or slightly above requirements. If weather conditions until fall are favorable, food inflation in 1993 will be as low as 2-3 percent. On the other hand, if Asian grain harvests should decline sharply, with stockpiles depleted, food prices worldwide could add to inflationary pressures by year end. Thus far, however, U.S. food and agribusiness sectors have been unable to raise prices materially in the recent highly competitive, weak demand environment.

Farmers are retrenching as income prospects fall 15 percent below the record 1990 level. Spending by farm families is not likely to help farm area economies recover this year or next. Large tractor sales are 17 percent below the slow 1991 pace. Grain harvester sales are off nearly 50 percent. The farm economy is financially strong, however, with aggregate debt down 30 percent from the 1982 peak of $200 billion. Nothing like the 1983-87 farm recession is on the horizon. The outcome of the 1992 election is unlikely to affect the farm economy materially. Budget pressures, however, will continue to force cuts in farm subsidies.

	1991	1992e
Farm cash income (billions)	$57	$53
Retail food prices (% change)	+2.9	+1-2

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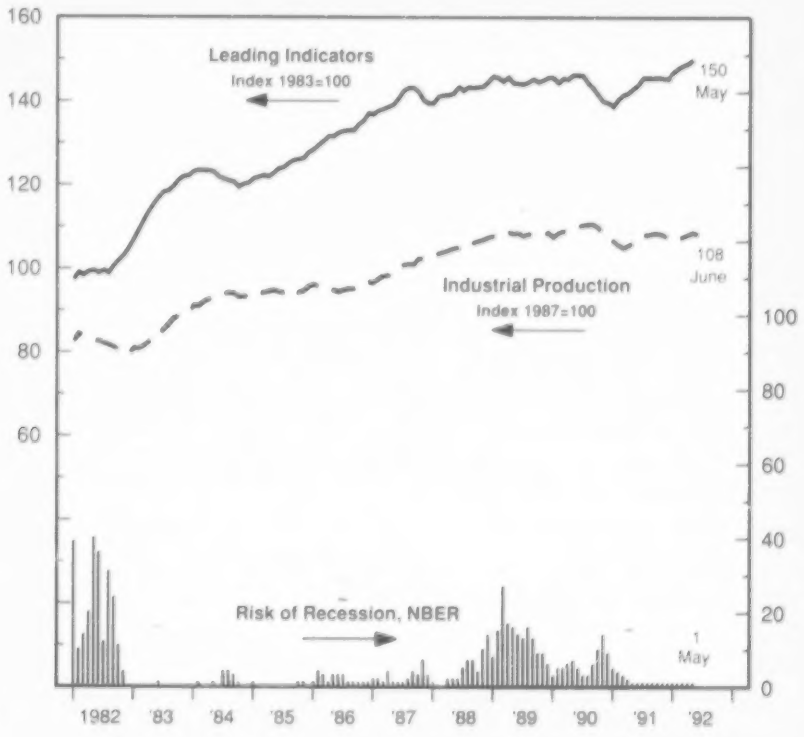
Still More Optimism

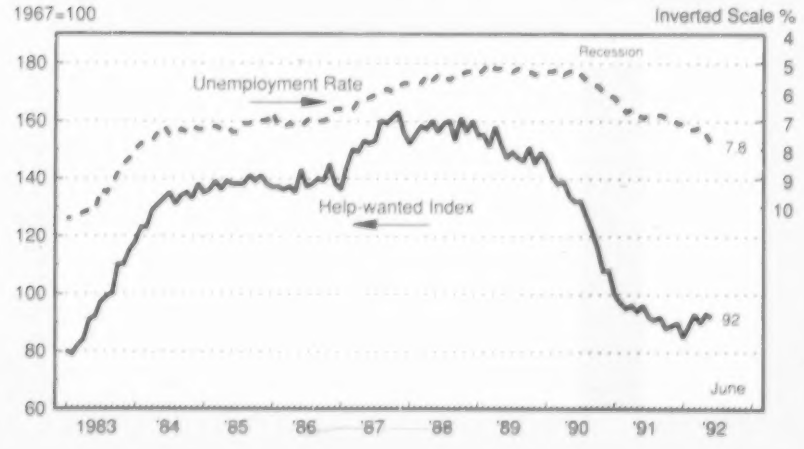
The ink was barely dry on our conclusion last month that the U.S. business cycle was tracking a "routinely satisfactory pattern," when that judgment was demolished by June's negative employment-unemployment report. Nevertheless, despite the rampant pessimism that pervades the country, or at least the media, we still believe the economy remains on a slow but self-sustaining recovery. Furthermore, with uncharacteristic boldness, we will venture another optimistic forecast: Assuming no major energy supply shock or similar event, inflation should continue to be quite benign for several years ahead. Why? Because the recovery is slow and idle labor and capital are plentiful. This combination tells us it will be a long time before the economy sees unemployment low enough and factory operating rates high enough to blunt the strong competitive pressures that are keeping wages and prices under firm control currently. In fact, it could easily be the second half of this decade before the economy pulls close enough to full capacity to trigger a new inflationary speed-up. (Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

Early Warning Indicators



Leaders look lovely.

Help-Wanted Advertising and Unemployment

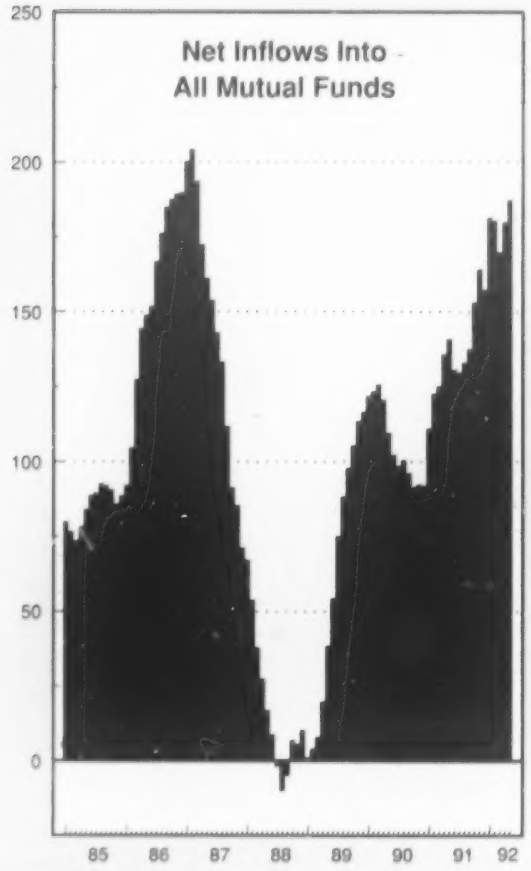


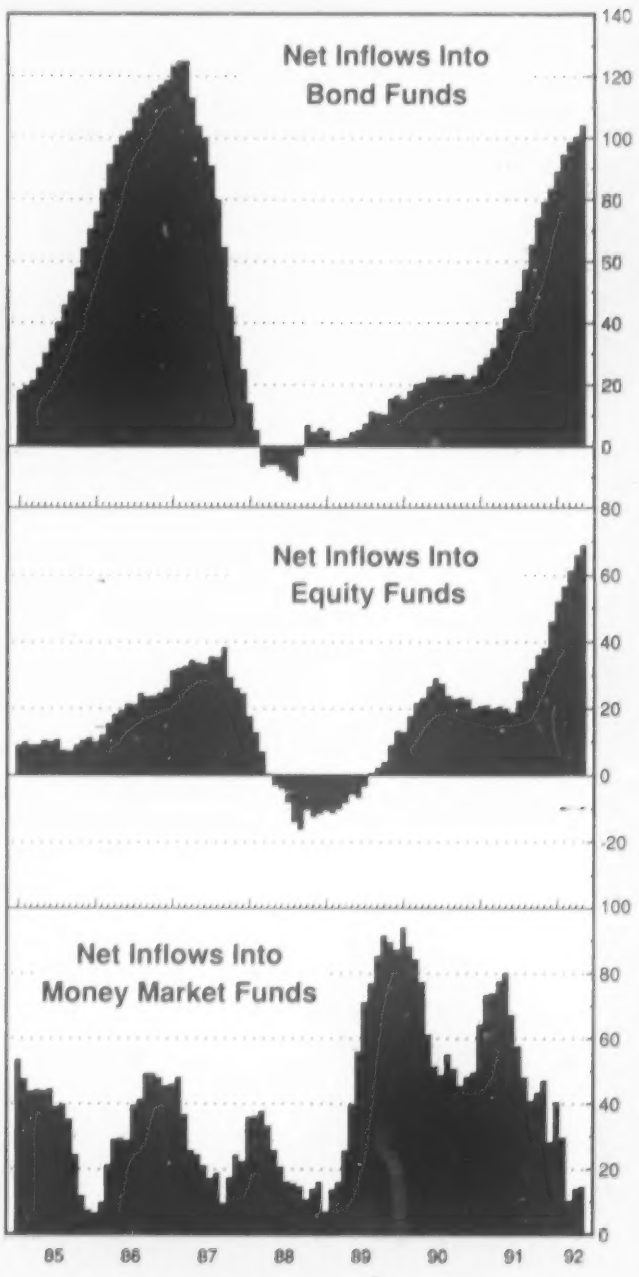
Labor markets even weaker.

Chart of the Month

Net Flows Into Mutual Funds

$ billions, 12-month moving sums, including reinvested dividends





Source: Investment Company Institute

Mutual Funds Inflows Surge

The mutual fund industry is having a banner year, with the total dollar inflow climbing rapidly toward an all-time high. A prime force behind this surge is the recession-related drop in short-term interest rates, which at this level (in contrast to the rates offered a few years ago) leave savers less than satisfied with the rates now being paid on many bank accounts, where most of the money is coming from. Correspondingly, the bulk of the money is targeted for bond and equity funds, rather than the money market funds where the inflows have slowed sharply. Currently, the flow into equity funds is almost twice as large as the previous record in 1987.

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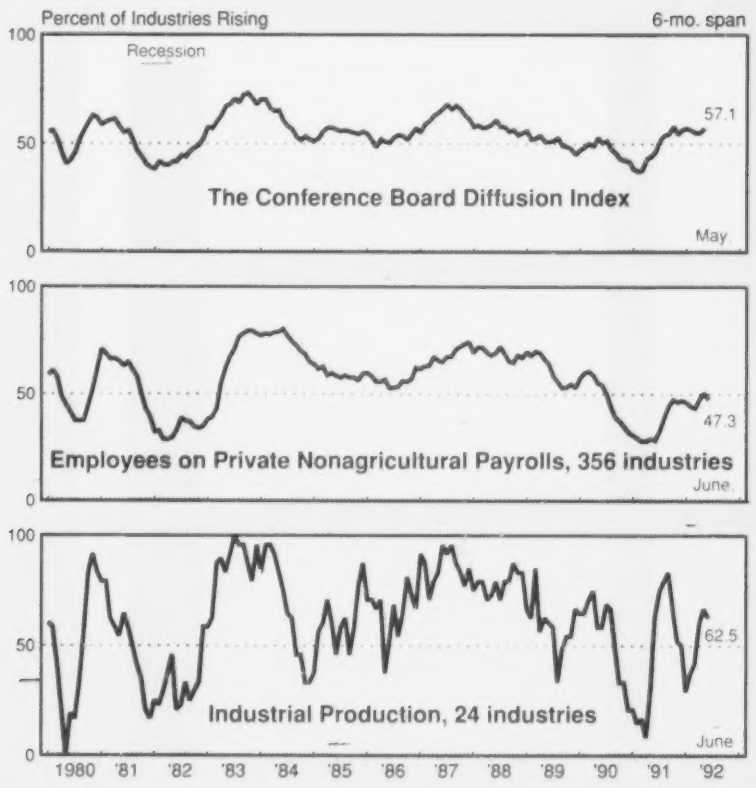
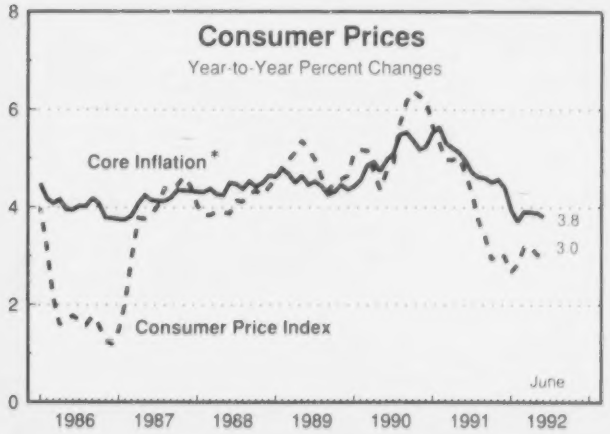
Indexes of Economic Momentum



Economy is developing a modest momemtum.

Inflation well behaved.

Inflation Fundamentals



* Core Inflation = CPI excluding food at home and energy.

* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

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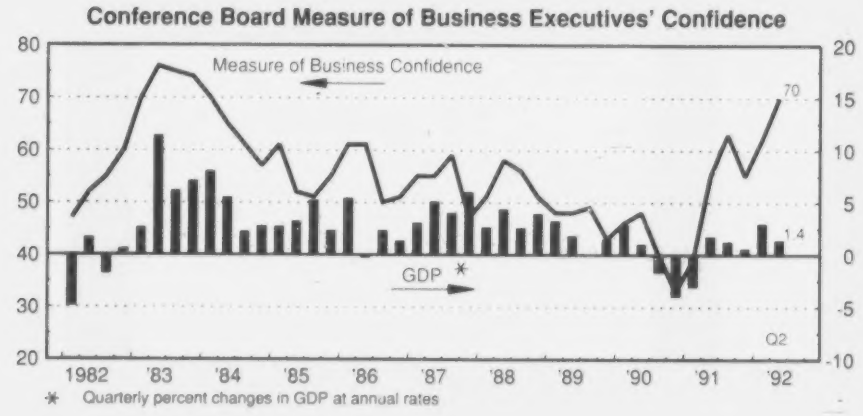
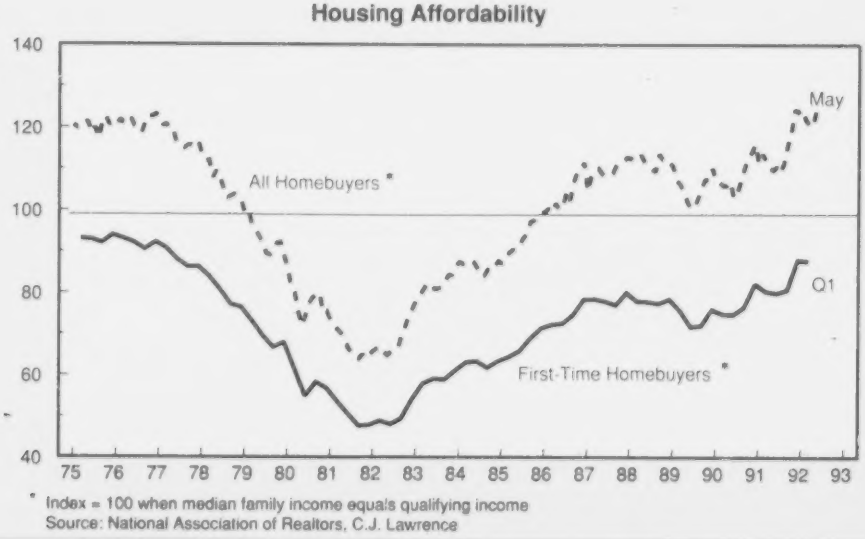
Confidence



Consumer expectations dip again. Executives quite bullish.

Chart of the Month-II

As Ed Yardini and Debbie Johnson of C.J. Lawrence observed in the July 20, 1992 issue of their weekly Economic Briefing, *"Housing affordability is very high, but so is job insecurity."*



Inside the Crystal Ball

		UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN - RSQE			
Date of Forecast		July	July	July	July	July	July	July	July	July	July	May			
Gross Domestic Product		(Quarter-to-quarter percent change, constant dollars, seasonally adjusted at annual rates)													
		%	%	%	%	%	%	%	%	%	%	%			
Actual	1991 4Q	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	4Q 1991		Actual
	1992 1Q	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.4	1Q 1992		
Forecast	2Q	2.1	1.8	2.8	1.2	2.5	2.0	2.1	2.4	2.2	2.5	1.9	2Q		Forecast
	3Q	2.3	1.5	3.1	1.6	3.1	2.1	3.4	2.8	3.6	2.6	3.5	3Q		
	4Q	2.6	2.8	3.2	2.9	3.0	1.2	3.1	2.8	2.6	2.8	4.0	4Q		
	1993 1Q	3.8	3.0	3.6	2.7	3.0	1.5	3.6	3.0	2.9	3.3	4.3	1Q 1993		
	2Q	4.3	3.1	3.9	2.9	3.3	3.0	4.8	3.0	2.7	3.2	4.0	2Q		
	3Q	3.3	3.0	3.7	3.2	3.0	2.5	3.3	3.1	3.0	2.9	3.2	3Q		
	4Q	3.3	2.6	3.5	2.6	2.7	2.2	2.6	2.9	2.9	3.0	2.6	4Q		
	1994 1Q	2.8		3.4			1.9		3.0	3.3	3.0		1Q 1994		
	2Q	2.5		3.3			2.2		2.9	3.1	2.7		2Q		
Inflation (Deflator)		(Percent change from same quarter one year earlier)													
Actual	1991 4Q	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	1991 4Q		Actual
Forecast	1992 4Q	3.2	2.8	3.4	2.9	3.1	3.1	2.4	2.8	2.8	3.3	2.9	1992 4Q		Forecast
	1993 4Q	3.3	3.0	3.6	3.4	3.3	2.5	2.5	2.9	2.9	2.4	3.2	1993 4Q		
30-Yr Treasury Bond Rate		(Percent, quarterly)													
Actual	1991 4Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	4Q 1991		Actual
	1992 1Q	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	1Q 1992		
Forecast	2Q	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	7.9	2Q		Forecast
	3Q	8.1	7.5	7.5	7.7	7.5	7.8	7.7	7.7	7.8	7.5	7.9	3Q		
	4Q	8.2	7.5	7.5	7.9	7.5	7.8	7.7	7.6	7.8	7.5	7.8	4Q		
	1993 1Q	8.4	7.7	7.6	8.1	7.5	7.8	7.8	7.6	7.9	7.6	7.7	1Q 1993		
	2Q	8.4	7.9	7.7	8.2	7.5	8.2	7.8	7.6	7.9	7.7	8.0	2Q		
	3Q	8.2	8.0	7.8	8.3	7.5	8.2	7.8	7.5	8.1	7.8	7.9	3Q		
	4Q	8.1	8.1	7.9	8.3	7.5	8.2	7.8	7.4	8.1	7.9	7.7	4Q		
	1994 1Q	8.0		8.0		7.6	8.2		7.2	8.2	8.0		1Q 1994		
	2Q	7.9		8.0			8.3		7.1	8.2	8.1		2Q		
Unemployment Rate		(Percent, quarterly)													
Actual	1991 4Q	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	4Q 1991		Actual
Forecast	1992 4Q	7.1	7.5	7.4	7.6	7.1	7.6	7.3	7.0	7.1	7.4	7.1	4Q 1992		Forecast
	1993 4Q	6.2	6.5	6.6	6.9	6.7	7.2	6.6	6.2	6.5	6.7	6.3	4Q 1993		
	1994 1Q	6.0		6.4			7.1		6.1	6.3	6.5		1Q 1994		

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